THE LAW AND FINANCE OF MERGERS AND ACQUISITIONS

SUPPLEMENTARY MATERIALS

SPRING 1995

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Course Outline

The Law and Finance of Mergers and Acquisitions
Spring Term, 1995

Professors Daniels and Halpern and Mr. Balfour

The purpose of this course is to acquaint students with the legal and institutional framework governing mergers and acquisitions transactions in Canada from a finance perspective. The course will address these issues by focusing on the contested acquisition of Lac Minerals by American Barrick in the Summer of 1994. The materials in the course are organized to track the development of the transaction. While organizing the materials in this fashion means that some legal and finance issues that might otherwise have been covered in the course will not be, it is our hope that the loss in breadth will be more than compensated for by the opportunity to explore the strategic negotiation and planning issues that arise in this area by focussing on a specific transaction.

While the course will pitched at a level that should be accessible to any student who has taken Business Organizations I and has had a smattering of exposure to economics or finance, it may be worthwhile to tool up for the course by reviewing the first 250 pages of Gilson and Black. These materials provide a basic finance background for law students.

Evaluation will be by class participation (10%), 5 short notes based on the weekly readings (approximately 1-2 pages) (20%), and a 25 page paper on a topic of interest to the student (70%).

Required Texts:

(i) Consolidated Ontario Securities Act (1994 or 1995)

(ii) Canada Business Corporations Act (1993 or 1994)

(iii) Ontario Business Corporations Act (1993 or 1994)

(iv) Ronald Gilson and Bernard Black, The Law and Finance of Corporate Acquisitions: 1993 Supplement (Westbury, New York: The Foundation Press, 1993) ("GB")

(v) Supplementary Materials for "The Law and Finance of Mergers and Acquisitions" ("Supp")

(vi) Case Study Materials for "The Law and Finance of Mergers and Acquisitions" ("CSM")

(vii) Ziegel, Daniels, Johnston, and MacIntosh, Cases and Materials on Partnerships and Canadian Business Corporations (Toronto: Carswell, 1989) ("ZDM")

Class 1: Administrative Issues and Overview

Classes 2-4: What Motivates Mergers and Acquisitions?

There are several possible motivations that explain the purchase and sale of firms and assets, including: managerial inefficiency, synergy gains (economies of scale and scope), anti-competitive behaviour, financial diversification, redistribution of stakeholder wealth, and managerial hubris and/or mistake. In these classes, we will consider the nature of each of these motivations, and relevant empirical data. One central conundrum we will grapple with is why mergers and acquisitions (essentially transfers of ownership) are favoured over long-term contracts such as joint ventures?

Once the general theoretical materials have been explored (and there are alot), we will then turn to the specifics of why American Barrick and Royal Oak sought to acquire Lac. Which motivation best describes American Barrick's interest in Lac? This discussion will take place with sensitivity to the nature of the gold mining industry in Canada, and the domestic and international economic trends affecting it.

Readings:

(a) Operating Synergies: GB 259-313;

(b) Pure Diversification and Financial Synergy: GB 316-370;

(c) Replacement of Inefficient Management: GB 370-409;

(d) Tax Motivations: Chapter 11, Business Combinations, from: Dan Thornton, Managerial Tax Planning (Wiley & Sons, Toronto: 1994) (Supp. pg. 1-20).

(e) Other miscellaneous motivations: GB 568-596.

(f) Accounting Treatment of Mergers and Acquisitions in Canada: Purchase versus pooling of interests: Discussion on pooling versus purchase accounting from pp. 850-853, Dan Thornton, Managerial Tax Planning (Wiley & Sons, Toronto: 1994) (Supp. pg. 21-25).

(g) "Record Year!!! Mergers & Acquisitions Reach $35 Billion", Mergers & Acquisitions in Canada, Vol. 6, Issue 1, January 1994.
"Record M&A Levels in 1994: Cross Border M&A Activity Increasing",

Mergers & Acquisitions in Canada, Vol. 6, Issue 7, July 1994.
Philip Goodeve, "A new M&A Market Reshaping Corporate Canada", Mergers & Acquisitions in Canada, Vol. 6, Issue 8, August 1994 (Supp. pg. 25-32).

Classes 5-7: The Rules of the Road and the Structure of the Bid

Once an acquiror decides to bid for a company (either friendly or hostile), its activities are governed by certain "rules of the road" set out in securities law, corporate law, and stock exchange listing rules. The rules deal with disclosure obligations, minimum bid periods, pro rata sharing of the control premium, and so forth. In these classes, we will canvass these rules, and assess their impact on private ordering. Having explored the legal and financial framework for mergers and acquisitions transactions, we will then examine how parties in the Lac contest structured their bids so as to gain maximum advantage in the shadow of this framework.

(a) Statutory Materials: OSA 89-105; OSR 182-204, Form 32?; and CBCA 147-155 (proxies) and 194-207 (takeover bids).

(b) When do the takeover rules apply?: Asbestos Corporation Limited, Societe Nationale de l'Amiante and Sa Majeste du Chef du Quebec, (1992), 10 O.R. (3d) 577 (C.A.) (Supp. pg. 33-43).

(c) Early Warning System: Proposed Changes to EWS (Request for Comments, September 16, 1994 O.S.C.B. 4437) (Supp. pg. 44-56).

(d) Pre-Integration Rules: "Noranda Inc./Falconbridge Limited -- OSC Press Release", (1988), 11 O.S.C.B. 4367 (Supp. pg. 57-58).

(e) Disclosure Obligations: Basic, Inc. v. Levinson, 108 S.Ct. 978 (1988) in GB 1020-1049; Standard Broadcasting Corporation Limited, Slaight Broadcasting Inc., and Selkirk Communications Limited (1985), 8 O.S.C.B. 3672; Royal Trustco Ltd. v. OSC (1983), 42 O.R. (2d) 147 (O.H.C.) (Supp. pg. 59-68).

(f) Indirect Offers and Acting in Concert: Oakwest Corporation Limited and Capricorn Capital Corporation (1988), 11 O.S.C.B. 744; (Supp. pg. 69).

(g) Identical Consideration and Collateral Agreements: Consolidated Bathurst Inc., January 13, 1989 O.S.C.B. 320; Geoffrion, Leclerc Inc., April 21, 1989 O.S.C.B. 1563; CDC Life Sciences Inc., June 17, 1988 O.S.C.B. 2541; The Enfield Corp. Ltd., August 10, 1990 O.S.C.B. 3363 (Supp. pg. 70-107).

(h) Anti-dilution Rules: Toronto Stock Exchange By-Laws - Part XIX, Sec. 19.06, "Change in Outstanding Capital"; In the matter of Torstar Corporation and Southam Inc., December 6, 1985 O.S.C.B. 5068; In the matter of Torstar

Corporation and Southam Inc. (additional reasons), June 6, 1986 O.S.C.B. 3088 (Supp. pg. 108-164).

Classes 8 and 9: Poison Pills and Defensive Tactics

The appropriate scope for management defensive tactics in response to a hostile takeover bid is one of the most vexing theoretical issues in modern corporate law. As you will recall from earlier courses, the problem is that management (meaning the target's board of directors and senior officers) have conflicting loyalties (to themselves and to shareholders). The concern, of course, is that management will often lose its position in a change of control transaction and thus has strong incentives to work against prospective acquirors. From a legal/institutional perspective, the difficulty is that by engaging in defensive tactics, target managers can confer significant ex post gains on shareholders, but these gains are attended by certain costs: increased risk that the specific transaction will not be consummated, reduced incentive for would be acquirors to bid for companies because of increased cost, and greater opportunities for managers to negotiate side payments to themselves. The most effective defensive tactic by far is the shareholder rights plan or, in common parlance, the "poison pill".

In these classes, we will explore the theoretical and empirical literature governing defensive tactics, and then review the law and institutional framework for defensive tactics, focusing particularly on the poison pill. We will consider how the law can best handle the theoretical and practical uncertainties of knowing when managers have "crossed the line" and are favouring their own interests over the interests of shareholders when they resist a change in control. Of special relevance to Canada is the issue of whether and why courts or securities regulators (or, perhaps both) should be regulating managerial defensive tactics. As you will see, in its reason decisions, the OSC has focused on the issue of shareholder choice, while sedulously avoiding any suggestion that they are trenching on the turf of directorial fiduciary duties. We will discuss whether this distinction is tenable, particularly in light of the fact that Canadian issuers are required by the OSC to obtain shareholder approval when adopting poison pills. Finally, we will ground all of this discussion in the machinations surrounding the Lac transaction.

(a) Lipton, Fogelson, Brownstein and Wasserman, "Mergers and Acquisitions: Developments in Takeover Techniques and Defense": ZDM 597-605; Poison Pills: GB 621-626; Robert Comment and G. William Schwert, "Poison or Placebo? Evidence on the Deterrent and Wealth Effects of Modern Antitakeover Measures", Working Paper No. 4316, National Bureau of Economic Research, Inc. (April 1993) (Supp. pg. 165-184).

(b) Legal Materials: National Policy Statement 38; Unocal; Moran; Revlon; City Capital v. Interco; Mills; Paramount v. Time in GB 626-894; Paramount v. QVC (Sup. Ct.); Canadian Jorex Ltd. January 24 1992 O.S.C.B. 257; Lac Minerals

Ltd. and Royal Oak Mines Inc. October 21, 1994 O.S.C.B. 4963; MDC Corporation and Regal Greetings & Gifts Inc. October 12, 1994 O.S.C.B. 4971; (Supp. pg. 185-261).

Classes 10 and 11: The Friendly Transaction

With our focus on the Lac transaction, one might be led to believe that most mergers and acquisitions in Canada are hostile in nature. This couldn't be further from the truth. In both Canada and the United States, hostile transactions constitute only a very small percentage of the M&A transactions concluded each year. In this class, we will explore the ways in which these transactions are legally effected, and the nature of director and managerial duties in these situations. Specifically, what duties do directors owe to minority shareholders? Do these duties include an obligation to shop the company for the highest possible bid? Should, and under what circumstances, lock-ups be available? We will also address the difficult issue of how the law should manage private sales of control, and, in particular, the sharing of control premia. What impact has the equal opportunity rule enshrined in Canadian securities law had on sale of control transactions?

(a) How to Do Them: (i) Sale of Assets: CBCA 189, 190; OBCA 183, 184; Gimbel v. Signal Companies, Inc. Court of Chancery of Delaware, 1974 316 A. 2d 599 (); Katz v. Bregman Court of Chancery of Delaware, 1981 431 A. 2d 1274 (); F.H. Buckley and M.Q. Connelly, Corporations: Principles and Policies, The Qualitative Test (Toronto: Emond Montgomery, 1988); (ii) Amalgamations CBCA 181 - 186; OBCA 173 - 178; (iii) Statutory Arrangements: CBCA 192; OBCA 183 - 183 (Supp. pg. 262-272).

(b) Directors' Duties in Friendly Changes of Control: Brant Investments Ltd. v. Keeprite Inc. (1988) 37 B.L.R. 65 (S.C. Ont.); Smith v. Van Gorkum 488 A.2d 858 (Del. S.C. 1985) in ZDM (467-478); CEDE & Co. v. Technicolor (October 1993) (Sup.Ct. Del) (Supp. pg. 273-312).

(c) Lock-ups: Revlon (reprise); Steve Fraidin & Jon Hanson, "Toward Unlocking Lockups" (1994), 103 Yale L.J. 1739 (Supp. pg. 313-408).

(d) The Equal Opportunity Rule and the Private Agreement Exemption: F. Easterbrook and D. Fischel, "Corporate Control Transactions" in ZDM 757-764; Selkirk Communications Ltd., January 22, 1988 O.S.C.B. 285; H.E.R.O. Industries Ltd. September 14, 1990 O.S.C.B. 3775 (Supp. pg. 409-452).

Classes 12 and 13: Going Private Transactions

Going private transactions can take a number of different forms. First, in the case of a management buyout ("MBO"), a managerial group, usually with scant existing shareholdings, acquires the company. Second, in the case of a majority buyout, an existing majority shareholder, either an individual or corporation, acquires the company. In Canada, such acquisitions can be effected in a number of different ways, including: takeover or issuer bids, squeeze-out amalgamations, or statutory arrangements. Finally, in the case of a compulsory acquisition, a shareholder who has acquired in excess of 90% of a class of shares can expropriate the remaining shares from outstanding shareholders, subject to prescribed safeguards.

In these classes, we will explore the different techniques to effect these transactions. Here, we will focus on the factors that drive one choice of transaction over another. For instance, what drives an existing acquiring shareholder to favour an MBO over other techniques such as a dual class share recapitalization? We will then examine the nature of, and rationale for, the various legal regimes governing these transactions. We will be particularly sensitive to innate conflicts of interest among shareholders and managers or shareholders inter se in these transactions. Further, we will address the problem of coercion in these transactions, and the law's role in constraining opportunitistic behaviour. Finally, we will discuss the adequacy of the appraisal remedy as a safeguard protecting minority shareholder interests.

1. Freezeouts, MBOs & Clean-up Transactions

Brudney and Chirelstein, "A Restatement of Corporate Freezeouts" (1978), 87 Yale L.J. 1354 at 1357-1376: ZDM 722-730.

Variations on a Theme: Management Buyouts and Going Private (Supp. pg. 453-454).

The American Law Institute, Principles of Corporate Governance: Analysis and Recommendations, Reporters' Study No. 1, Transactions in Control, pp.15 to 18, February 22, 1985 (Supp. pg. 455-456).

DeAngelo, DeAngelo & Rice, Going Private: Minority Freezeouts and Stockholder Wealth, 27 J.L. & Econ. 367, 371-74 (1984) (Supp. pg. 457-459).

Gilson and Black, The Law and Finance of Corporate Acquisitions (pages 1002-1018).

The Problem of Minority Shareholders, including, Sinclair Oil Corporation v. Levien 280 A.2d 717 (S.Ct. Del. 1971) (Supp. pg. 460-468).

The Clean-up Transaction.

2. The Techniques

(i) Statutory Compulsory Acquisition

(ii) Amalgamation

(iii) Arrangement

(iv) Amendment of articles

(v) Issuer and insider bids

3. The Law

(i) Compulsory Acquisitions

CBCA 206

OBCA 186

(ii) Other Transactions

CBCA Part XVII

OBCA 190

OSA Part XX and OSR Part X

OSC Policy 9.1

Singer v. Magnavox Co. 380 A.2d 969 (Del. S.C. 1977): ZDM 730-732.

Weinberger v. UOP, Inc. 457 A.2d 701 (Del S.C. 1983): ZDM 734-744.

Palmer v. Carling O'Keefe Breweries of Canada Limited (1989) 41 B.L.R. 128 (Ont. Div. Ct.) (Supp. pg. 469-476).